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PASS FED BOARD OF GOVERNORS FOR KROZNER
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E.O. 12958: DECL: 05/21/2017
TAGS: [PREL](#) [ECON](#) [EFIN](#) [EINV](#) [AR](#)
SUBJECT: ARGENTINA IN PLAY: RE-ENGAGING ON ECONOMIC AND
DEBT MANAGEMENT

REF: A. BUENOS AIRES 801

[1](#)B. BUENOS AIRES 680

Classified By: Ambassador E.A. Wayne. Reasons 1.5 (b,d)

Summary and Introduction

[11.](#) (C) We need to re-engage with Argentina on broad economic policy and debt management issues. This re-engagement should be both with GoA officials and with this nation's vibrant and diverse civil society and media. In the big picture, Argentina is in play. We should not abandon the field to the models and approaches being offered by Chavez, especially when there is so much skepticism about him among Argentines. More narrowly, we can and should influence Argentine thinking and actions on economic policy in the future.

[12.](#) (C) Below the rhetorical fog of an election year, many Economy Ministry, Planning Ministry and Central Bank officials are acknowledging the need for post-election economic policy changes. They are beginning to contemplate politically feasible ways to regularize debt arrears and relations with international capital markets and, more broadly, how to modify Argentina's heterodox economic model in ways that will temper inflationary pressures and permit growth to continue at more sustainable levels. In the media, commentators and editorialists regularly call for policy changes and warn of the consequences of if the GoA fails to evolve its approach to economic management.

[13.](#) (C) This is not about liking Kirchner or not; it is about supporting a market orientation and democratic institutions in Argentina. While the Kirchner administration's politically calculated populist rhetoric often makes the GoA difficult to deal with, Argentina remains a large and important economy in Latin America and we have common interests in many areas -- including law enforcement and security -- that are a base for

gradually improving relations.

14. (C) Low-key, substantive discussions at senior USG levels on these themes would help convince Argentina of the near term benefit of paying down its Paris Club arrears and of settling with bond holdouts; strengthen the hand of local officials who favor market liberalizations and want to work with us; and counter the siren's call of Venezuelan populism in a nation with the highest anti-American polls in the hemisphere. A senior U.S. presence sharing our outlook with the media here can particularly influence public discourse for the better if handled carefully.

15. (SBU) Action Recommendation: Near term engagement opportunities include requested bilaterals at the June 10-12 Americas Competitiveness Forum in Atlanta between Economy Minister Miceli and Treasury Secretary Paulson and between Planning Minister De Vido and Commerce Secretary Gutierrez. We understand that Secretary Paulson is considering a visit to Brazil, Uruguay and Chile in July. Adding Argentina to Secretary Paulson's regional itinerary would allow him to

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engage a broad range of senior GoA officials and equally importantly with civil society and the media. We think the impact could be very positive and substantial.

End Summary

The Consequence of Limited Engagement

16. (C) In the year and a half following President Kirchner's poor treatment of President Bush at the Mar de Plata Summit of the Americas, senior level bilateral engagement has been

limited to visits by U/S Burns, A/S Shannon, Attorney General Gonzalez and DUSTR Veroneau. President Bush's March 2007 Latin American tour, which included stops in Brazil and Uruguay but not Argentina, was certainly marred by President Kirchner's decision to grant Chavez a venue here for his parallel "anti-imperialist" tour. Subsequently there has understandably been a hiatus in senior level meetings given President Kirchner's unacceptable behavior. But, the challenge for USG policy is much broader. We need to counter pervasive anti-American sentiment here: Argentina has the lowest U.S. approval ratings, in the mid-20% range, of any country in the Western Hemisphere. A central USG policy objective here must be to counter this anti-Americanism, to take the opportunity to demonstrate we care about the country and people of Argentina (independent of its President's antics), that we support Argentine democracy and its market-based approach and that, of course, we are looking out for our economic interests and those of our citizens. One unfortunate result of not engaging at senior levels is leaving the field open to Chavez and others to present their vision of South America's future unopposed.

GoA Reaching Out on Debt and Economic Policy

17. (C) We think there are specific opportunities to engage in the economic field. In recent discussions with Ambassador (BsAs 680) Economy Minister Miceli and Finance Secretary Chodos have made clear that the GoA appreciates the importance of resolving Paris Club arrears and subsequently addressing bond holdouts as steps on the path to fully re-integrating Argentina into global capital markets. Practically, they also understand that clearing Paris Club arrears is a condition precedent for Argentina to re-gain access to G8 export credit agency credits which are needed to accelerate construction of urgently needed energy and transportation infrastructure upgrades.

18. (C) Both Miceli and Planning Minister De Vido, as well as Investment Coordinator Nofal have also hinted at the GoA's post-election intent to gradually unwind inefficient and

unsustainable price controls that are already leading to shortages and black markets in primary consumption items. Central Bank Governor Redrado (BsAs 801) has acknowledged the growing structural disequilibria imposed by the GoA's pro-cyclic stimulation of aggregate demand and maintaining low and sometimes net negative real interest rates. He told the Ambassador and Federal Reserve Bank Governor Kroszner May 15 (Septel) that he is quietly urging Minister Miceli and other key GoA officials to use all available policy tools -- monetary, fiscal, exchange rate, and wages -- to slow the post-election growth of aggregate demand and bring about a soft landing, with a more sustainable 4-5% annual real growth rate and lower inflation. Miceli told Kroszner and Ambassador (Septel) that she has approval to try to build a consensus on a long-term development strategy, drawing from the experiences of Chile, Ireland, South Korea and others.

Countering Chavez' Populist Message

¶9. (SBU) Rapid Argentine GDP growth since the 2001/2 economic crisis has dramatically reduced unemployment, poverty and indigence. However, such growth has also aggravated income inequality and made Chavez' populist message more appealing to segments of Argentine society, particularly those who remain in the informal economy. But, while the GoA's economic policy mix does include doses of selective market interventions and state ownership, the Argentine economy remains broadly private sector oriented. Senior GoA

officials have regularly announced that Chavez's socialist path is not for Argentina.

¶10. (SBU) Despite Argentina's market orientation and relative wealth (Argentina's per capita GDP is second only to Uruguay's in South America and roughly 1.5 times that of Venezuela's), Chavez has been able to exploit this nation's lack of access to investment capital and international financing. Burgeoning growth has strained domestic energy, roads, port facilities and sanitation infrastructure to the breaking point. But domestic and foreign investors, concerned by the GoA's affinity for abrupt regulatory and tax policy shifts and by growing structural disequilibria inherent in the GoA's economic management model, are not investing the volumes of long term capital needed to develop priority infrastructure. Unresolved post-crisis defaults on official Paris Club and private bondholder debt are complicating Argentina's access to the volume of new sovereign credits in global capital markets it needs to fund this infrastructure development on its own.

¶11. (C) Chavez has worked successfully to fill the resulting financing and investment gap. He has provided the Kirchner administration important breathing space in international financial markets by acting as an intermediary to place \$4.2 billion in new GoA sovereign debt issues at a time when bond holdout lobbies are demanding more aggressive USG efforts on their behalf and continuing efforts to attach vulnerable GoA assets abroad. Venezuela also structured a high profile rescue of a struggling Argentine dairy cooperative, offering a long-term barter solution (loans for commitments to export powdered milk) that avoided a buy-out by a U.S. investment fund and fit well with Kirchner administration efforts to retain local Argentine control of key economic sectors. The two countries have signed numerous other economic cooperation agreements that will primarily benefit Argentine exporters. The obvious quid pro quo for this support has been GoA advocacy for Venezuela within Mercosur and the UN (e.g. support for the GoV's Security Council candidacy and, most recently, support for Chavez' Bank of the South initiative.), and offering Chavez an Argentine platform for his particular brand of Bolivarian rhetoric (e.g. the March 9 anti-Bush stadium rally).

¶12. (C) GoA officials, including De Vido and Foreign Minister Taiana, tell us that the government views its relationship with Venezuela through a pragmatic lens, taking what Chavez

is willing to offer and making sure he delivers on all/all promises. For its part, Venezuela does not appear to have provided Argentina any significant subsidies or outright grants: In fact, GoA debt instruments purchased by Venezuela have, according to Emb Caracas reporting, netted the GoV Finance Ministry a tidy profit as it "flips" its inventory of Argentine debt to select domestic constituencies and to international investors at favorable exchange rates (albeit at the expense of the Venezuelan Central Bank). The GoV's rescue of the Argentine dairy cooperative offered financing at market-linked rates and required Venezuela to purchase Argentine powdered milk at prices linked to global commodity levels.

Paying Down Paris Club Arrears in GoA's Interest

¶13. (C) The obvious counter to the influence that Chavez' financial support has bought him in Argentina is to help the GoA regain direct access to international financial markets and to work with the GoA to develop the kind of investment climate that will attract the volume of domestic and foreign investment needed to build new foundational infrastructure at competitive costs.

¶14. (SBU) Argentina's access to private international financial markets will remain significantly restricted and more expensive pending Argentina's resolution of \$20 billion-plus in "bond holdout" debt. The GoA has repeatedly made clear that this issue is simply too politically sensitive to deal with prior to upcoming October/November elections despite our many urgings that they resolve the issue. The GoA has also made clear that a Paris Club agreement must come first. Billions in G8 export credits and OPIC-like investment financing could be made available to Argentina soon after the GoA clears its nearly \$4 billion in arrears and interest due on official Paris Club debt. Within the Paris Club, official USG Exim and OPIC credits (along with FMF and EDA) have been blocked under Brooke and 620-Q sanctions that were triggered in 2003 by arrears on a USAID credit. Not being able to provide FMF and EDA to the Argentine military ties our hands at exactly the moment the Ministry of Defense finally is looking at providing much-needed upgrades to equipment and systems. The military remains an important, pro-democratic institution in Argentina, predisposed to the U.S. Venezuela, China, Russia and others will gladly fill the gap in our absence.

¶15. (SBU) Currently, the GOA remains unwilling to pay down Paris Club arrears out of its ample reserves or fiscal surplus. An alternative rescheduling of arrears would require that GoA and official creditors overcome the stumbling block of an important Paris Club precedent that requires an IMF monitoring program be a part of any rescheduling. An IMF program remains politically unacceptable to a GoA that made a substantial populist play out of its 2005 \$9.5 billion pay-down of IMF outstandings. Yet the benefits for Argentina of finding some mechanism to clear Argentine Paris Club arrears would be substantial: A host of G8 export credit agencies appear eager to resume lending to support the kinds of capital goods exports that would help build Argentine infrastructure and improve efficiency.

¶16. (SBU) In addition to export credit agency financing, G8 investment credit agencies like our OPIC could support the kinds of foreign investment Argentina needs to incorporate modern technologies and international best practices into its productive economy. Post continues to encourage the GoA to resolve outstanding investment disputes, many dating from the 2001/2 economic crisis and to commit to the type of regulatory policy transparency and consistency that will both attract longer term investment and lower the risk premiums that such long term commitments of capital demands. The GoA is well aware that it is short of the kind of long term

investment needed to build and modernize basic infrastructure and sustain higher levels of economic expansion, domestic employment and income generation.

Comment and Action Request

¶17. (C) Argentina is debating its economic future. High and medium-level Economy Ministry, Planning Ministry and Central Bank officials are quietly reaching out to Post in search of politically acceptable ways to regularize debt arrears and relations with international capital markets and, more broadly, to modify Argentina's heterodox economic model in ways that will temper growing inflationary pressures and allow for a soft landing that will sustain reasonable growth levels. Private sector figures and media commentators are trying to counter Chavez-like visions of the economy in public and private. It is time for senior Washington decision makers to re-engage with Argentina's government and

with this nation's vibrant and diverse civil society and media on broad economic policy and debt management issues. Low-key, substantive discussions at senior USG levels on these themes would help convince Argentina of the near term value of paying down its Paris Club arrears and settling with U.S. and other bond holdouts; strengthen the hand of local officials who favor market liberalizations and want to work with us; and counter the siren's call of Venezuelan populism in a nation with the highest anti-American polls in the hemisphere.

¶18. (C) Argentina is in play and we should not abandon the field, especially when there is so much skepticism about Chavez among Argentines. Chavez has worked smart and successfully to influence domestic debate and to address Argentina's financing and investment gap. Senior Kirchner administration officials tell us they are getting value from Venezuela and discount the costs associated with the political (eg. Security Council seat advocacy, Banco del Sur participation) and polemical support the GoA provides Chavez in exchange. We need to work equally strategically to counter the influence that Chavez' strategy has gained him in Argentina. President Kirchner is famously obsessed with a daily tally of consolidated GoA revenue/payment flows and renewed availability of cost effective official export credits would go a long way to dampening the appeal Chavez holds for him. This, in turn, requires a renewed effort on our part to sit down with the GoA economic team and clarify the benefits of paying down Paris Club arrears. Argentina is now five years beyond its 2001/2 economic crisis and resolution of these official arrears is long overdue. The USG has a clear interest in putting the Paris Club impasse behind us.

¶19. (SBU) Action Request: A large GoA delegation, including the Economy Minister, Planning Minister, Investment Coordinator and Governor of Cordoba Province has agreed to attend the June 10-12 Americas Competitiveness Forum in Atlanta. Post requests that Commerce Secretary Gutierrez and Treasury Secretary Paulson agree to meet with their GoA Planning and Economy Ministry counterparts at this important conference. We also understand that Secretary Paulson is considering a visit to Brazil, Uruguay and Chile in July. Adding Argentina to Secretary Paulson's regional itinerary would allow him to engage a broad range of senior GoA officials and equally importantly with civil society and the media. We think the impact could be very positive and substantial.

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